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ABSTRACT

This cooperative extension bulletin provides basic information about credit cards and their use. It covers the following topics: types of credit cards (revolving credit, travel and entertainment, and debit); factors to consider when evaluating a credit card (interest rates, grace period, and annual membership fee); other credit card costs (late payment charges, fees for exceeding credit limits, charges for cash advances, and fees for special services); factors to consider when determining how many cards to carry; credit card consumer protection; unsolicited cards; disputes over merchandise or services; lost or stolen credit cards; credit cards and identification; secured credit cards, and federal enforcement agencies. (MN)

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CREDIT CARDS

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For more information

Bankcard Holders of America is a nonprofit organization focused on consumer credit problems. For a list of banks with favorable interest rates or a list of banks offering secured credit cards, contact Bankcard Holders of America, 460 Spring Park Place Suite 1000, Herndon, VA 22070. Telephone (703) 481-1110.

Reference to trade names is made with the understanding that no discrimination is intended nor endorsement implied.

CREDIT CARDS

Linda Kirk Fox, Extension Family Economics Specialist

Americans hold 310 million MasterCard and VISA cards — one card for every adult in the United States. Credit cards allow you to buy and use goods and services now, but pay for them later. They also may allow you to borrow money with minimum effort. Your credit card acknowledges that the credit card issuer will honor your credit, usually up to a predetermined limit. Credit cards are becoming more widely accepted than checks and less troublesome than carrying cash. However, credit purchases can be expensive if you do not use your cards carefully.

Types of credit cards

Revolving credit cards

These are revolving credit accounts for money you borrow. Revolving credit lets you make purchases up to a fixed dollar amount again and again. Each month you repay a portion of what you owe plus interest charges based on your outstanding balance.

Retail and single-purpose cards — These are revolving credit accounts issued by a single organization for use in purchasing goods from that organization only. Department store cards, gasoline cards, car rental cards and airline cards are among the most common. You usually don't pay a membership fee, and your credit is effectively free if you pay for your purchases within a 25- to 30-day grace period.

All-purpose cards — These are the most common revolving credit cards. With these cards you can purchase almost anything, almost anywhere. VISA, for example, is accepted at over 5 million establishments worldwide.

Although their names are the same and they often can be used interchangeably, all VISA cards are not alike nor are all MasterCards. More than 4,000 different financial institutions issue credit cards under the brand names VISA and MasterCard, and each issuing company sets its own policies regarding fees, interest rates, billing practices and extra features such as travel insurance.

Typically, you are charged an annual membership fee. You pay interest on your unpaid balance, and you usually enjoy a short grace period of free financing if you pay the balance in full each month.

Credit limits on all-purpose cards can range from several hundred dollars to several thousand dollars. All-purpose cards also offer a wide range of special services such as travel insurance, overdraft protection, credit card registration and discount shopping clubs. Some special services are included in the annual fee; others cost extra if you use them. Names: *Discover, MasterCard, VISA, American Express, Optima.*

Travel and entertainment cards

As their name suggests, these cards originally were designed for charging meals, hotels and similar services. Today they are used for merchandise and other purposes.

Travel and entertainment cards are charge cards, not credit cards. Charge card issuers require you to pay the balance in full each month; there is no interest rate. You are charged an annual membership fee that typically is higher than the fees for all-purpose credit cards. There may be no stated credit limit. Your limit is based on your normal spending patterns. These cards offer some credit options but at higher rates than credit cards. Some merchants do not accept certain travel and entertainment cards because they require higher processing fees, which the merchant must bear. Names: *American Express, Carte Blanche, Diners Club.*

Debit cards

Electronic Fund Transfer (EFT)

Debit cards are not credit cards. You do not borrow money but tap your own money in savings, checking or asset management accounts.

What constitutes a good credit card?

- Low interest rate
- 25- to 30-day grace period
- Little or no annual membership fee

Interest rates

In 1989 banks collected $17 billion in credit card interest revenue. At any time, 75 percent of active credit card accounts are incurring finance charges.

In many cases, you can eliminate your interest costs by paying your balance in full each month. To minimize interest costs, search for a credit card offering lower interest rates. Remember, many different institutions issue credit cards. Each sets its own interest rates and fees.

The highest interest rate a bank can charge is based on the laws of the state where the bank is located. However, banks lending to residents of other states can ignore those other states' laws. Some bankcard issuers have moved their credit card operations to states such as South Dakota and Delaware that have no credit card ceilings. Thus, a state such as Connecticut with an interest rate ceiling of 15 percent cannot stop a Citibank credit card operation in South Dakota from issuing VISA cards to Connecticut residents at 19.8 percent.

The results have been predictable. States are competing with one another for credit card processing jobs by seeing which can offer the most attractive environment for card issuers. Idaho repealed the Uniform Consumer Credit Code (UCCC) in 1983, eliminating the interest rate ceiling for credit cards.

Department stores are following the lead by establishing their own credit card banks in states without interest rate limits. For example, a clothing store based in Ohio charges all customers 22.8 percent (2 points shy of Ohio's ceiling, but up to 11 points higher than the top rates allowed in 31 other states). Other department stores have permission to open three credit card banks in Maryland, Ohio and Arizona where the percentage rate caps range from 24 percent to no cap at all.

Customers of stores that raise their interest rates may want to use a bankcard with a lower interest rate than the store's card. Typically, store credit card customers receive free catalogs or are offered private sales. In this case, keep your store account active with occasional purchases and pay your balance within the grace period.

How interest is calculated — Lenders apply the APR (annual percentage rate) to your account using one of three methods, listed from least to most expensive:

- The **adjusted balance method** subtracts your payments and credits during the month from the total amount you owe.
- The **average balance method** calculates the average of payments and charges for the previous month.
- The **previous balance method** does not take into consideration any payments you made during the month.

Three methods for calculating interest charges:

	Adjusted	Average	Previous
Monthly interest rate	1.5%	1.5%	1.5%
Previous balance	$500	$500	$500
Your payment (on 15th day)	$400	$400	$400
Interest charge	$1.50 (100× 1.5%)	$4.50 (avg. balance of $300×1.5%)	$7.50 ($500× 1.5%)

When you choose a credit card, especially one that looks like a bargain, read the fine print to be certain you understand how the balance and interest are calculated.

Grace period

The grace period is the time between purchase and the start of interest and finance charges. No grace period means you pay finance charges immediately upon purchase. The difference adds up fast. Suppose you make five $50 purchases within the monthly billing cycle with no grace period. Even with a low interest rate of 16.5 percent, you will owe $3.50 in interest that month. Avoid a card with no grace period.

Annual membership fee

The credit card issuer charges an annual membership fee for the privilege of using the card. For all-purpose credit cards, the fee generally ranges from $12 to about $20 per year. Premium cards usually cost more — from $50 to $80 annually. Your credit card membership fee may be automatically renewed and billed to your account each year. Banks claim they need to charge the annual fee to cover administrative costs.

If you were given a choice between a 19.8 percent interest rate with no annual fee and a lower interest rate of 17.76 percent with a $20 annual fee, which would you choose? Your choice should depend on the kind of credit user you are. If you usually pay bills within the grace period, choose the card with no annual fee. If you maintain a monthly balance due of $150 or less, you still would be better off without the annual fee and with the 2 percentage point higher interest costs. Only those who normally leave more than $1,000 of credit charges unpaid benefit from the lower interest rate because their interest savings will cover the annual fee.

Other credit card costs

Late payment charges

If you don't make the minimum monthly payment by the date specified on your statement, many credit card issuers typically charge an extra fee, say 5 percent of the amount past due, but not less than $1 or more than $5 per month.

Fee for exceeding the credit limit

Some financial institutions impose a fee of $10 or $15 each time you exceed your credit limit — the maximum amount that the bank or thrift institution is willing to let you borrow at any one time. Usually, the fee may be charged only once per billing cycle. Some institutions suspend your charging privileges until your balance is below your limit.

Charge for cash advance

Most cash advances, even those paid back within 30 days, run up interest from the moment you borrow the money. Some issuers are opting to replace the interest cost based on the annual percentage rate (APR) with a fee, for example, a 2.5 percent fee charged on the amount of the cash advance. Sound pretty good? You decide by comparing the fee assessed at 2.5 percent, which is not to exceed $10, with a typical APR of 20 percent:

Charges for cash advances calculated as an interest charge (APR) or percentage fee.

Cash advance	20% APR	2.5% Fee
$100	$1.67	$ 2.50
$200	$3.33	$ 5.00
$300	$5.00	$ 7.50
$400	$6.67	$10.00
$500	$8.33	$10.00

Fees for special services

Some of the special services available with credit cards are free, most frequently travel life insurance. However, many other services have an annual charge. Like your membership fee, these fees tend to be renewed automatically each year.

Should you buy special services? That depends on your needs, but keep in mind the criteria you use to evaluate the benefits you receive for the extra cost. For example, **travel discounts** of 5 percent on airline tickets or 10 percent on hotel accommodations could be justified if your stay is longer than a week. Rental-car collision insurance could save you $10 a day in fees if your existing automobile insurance doesn't cover rental cars. You can accumulate airline frequent flier points at the rate of 1 bonus mile for every dollar you charge.

Rebates, by which you earn so-called "dollars" based on the amount you charge, usually are limited to purchases of merchandise in the catalog. The best known cash-rebate program is Discover Card by Sears. However, the New York Consumer Affairs Department investigated two of the largest banks and found them guilty of misleading the consumer about rebates.

Some card issuers offer **purchase protection** to double the warranty period of goods you purchase with the credit card. Goods are protected against damage, loss or theft for 45 to 90 days after purchase. Read carefully the part of the contract explaining how you collect for lost or damaged goods. The credit card company may cover only what your existing homeowners or renters insurance will not.

Long-distance phone call service charged to your VISA card is now available with some long distance carriers. Another carrier offers its own Universal card — a MasterCard with a phone call charge privilege and other features.

Certain all-purpose and travel and entertainment card issuers offer more than one type of card. Their **premium cards** offer prestige along with higher credit limits and services such as personal credit lines. On the other hand, they may have higher annual membership fees and tougher eligibility requirements. Card names include *American Express Gold Card, Gold MasterCard* and *Premier VISA*.

Affinity credit cards allow you to show affiliation or association with a group or cause of your choice — a charity, favorite sports team, alma mater or social or environmental action group. For each purchase you make, the bank sponsoring the affinity card contributes to the group a small portion of the administration fee it receives from the merchant. Although the card may bring the prestige of visible association with the affinity card group, your financial support may be minimal and is based on the dollar amount of your purchases. Keep in mind that direct donations to the charity or cause may be tax deductible whereas the portion from your credit card purchases is not.

A **membership savings plan** makes it possible for you to be billed monthly for whatever amount you'd like to set aside in savings, from $50 to $5,000. That money is deposited in a financial institution. To withdraw funds from membership savings, you call a 24-hour 800 number then wait for the funds to arrive by check through the mail. For a fee, you can get a 24-hour wire transfer. There is no other fee and no penalty if you fail to save what you said you would. The interest earned on your savings is only slightly more than the average bank money market accounts.

Many credit card bonuses are duplicate safeguards or superfluous services. The bottom line basics: Know the true cost of the card — the interest rate, grace period and annual fee. It is no coincidence that the cards with the most features levy the highest fees.

How many cards should you carry?

For almost everyone with a mailing address, hardly a month goes by when they do not open the mailbox to find another bankcard offer. So it is wise to decide ahead of time how much credit you need and how many cards you want to carry. Consider the following:

- Not all merchants accept all cards.
- For bookkeeping purposes it is often convenient to carry one card for business expenses and another for personal use.
- If you shop regularly at one store, having a charge account there can keep your other lines of credit clear.

If you carry many different credit cards, be sure to consider the additional fees you are paying for each card and the increased risk of losing a card. Carrying many cards also makes it harder to keep track of your total credit debt.

Carrying a large number of credit cards, whether or not you actively use them, also can cause problems when you apply for other financing. Some lenders use your total credit limit as your current debt, even if you never actually charge up to your limits. So it may appear that you cannot afford additional credit. Whatever you decide, be sure to consider all the factors before applying for a new credit card.

Credit card consumer protection

Credit card issuers are required to clearly disclose financial terms in their promotional mailings. In the past, credit card issuers touted the fringe benefits — extras like travel insurance and warranties — before getting around to the actual costs. Now, card issuers must clearly state the annual fee, the percentage interest rate, whether the rate is fixed or variable and the grace period. Credit card issuers must notify you 30 days before the annual renewal date.

Unsolicited cards

It is illegal for card issuers to send you a credit card unless you ask for the card or agree to receive it. However, a card issuer may send you, without your request, a new card to replace an expiring one. A financial institution may send you a valid debit (EFT) card only if you ask for one.

Disputes over merchandise or services

After making a good faith effort with the seller over defective merchandise or services, you have the right to withhold payment. You can withhold payment up to the amount of the credit outstanding for the purchase plus any finance or related charges.

If the card is not issued by the seller of the defective merchandise, you can withhold payment *only* if the purchase exceeded $50 and occurred in your home state or within 100 miles of your billing address. If these conditions do not apply, you may consider filing a claim in small claims court.

Lost or stolen credit cards

If your wallet is stolen, your greatest cost may be inconvenience because your liability for lost or stolen credit cards is limited under Truth in Lending.

- If you report the loss before the cards are used, you do not have to pay for any unauthorized charges.
- If the thief uses your card before you report it missing, the most you will have to pay for unauthorized charges is $50 per card. This is true even if a thief uses your credit card at an automatic teller machine to access your credit card account.

To minimize your liability, keep a list of your credit card numbers and notify card issuers immediately. Do not waste any time. Beware the Good Samaritan calling! If you lose your cards and a few hours later someone calls saying your cards were found, don't be fooled into thinking you don't have to make all those calls. Any delay just gives the thief more time to run up your bill.

On lost or stolen debit (EFT) cards, your liability for unauthorized withdrawals can vary:

- Your loss is limited to $50 if you notify the financial institution within two business days after learning of the loss or theft of your card or access code.
- You could lose as much as $500 if you do not notify the card issuer within two business days.
- If you do not report an unauthorized transfer within 60 days after the statement on which it appears is mailed to you, you risk unlimited loss on transfers made after the 60-day period. That means you could lose all the money in your account plus your maximum overdraft line of credit.

What about a credit card registry? This service arranges cancellation and replacement of lost or stolen cards — a nice service when all your cards are lost or stolen at once. Yet paying for the registry or buying

credit card insurance to limit losses is not necessary. Legally, your liability is limited to $50 for each credit card. As for replacement, every card issuer has a phone number to call to report your loss or request replacement cards.

After the card loss, review your billing statements carefully. If your statements show any charges not made by you, send a letter to the card issuer describing each questionable charge. Again, tell the card issuer the date your card was lost or stolen and the date you reported it to the card issuer. Be sure to send the letter to the address provided for billing errors. Do not send it with your payment or to the address where you send your payments unless you are directed to do so.

Credit cards and identification

It is unwise to write your telephone number on credit or charge card purchase slips. Major credit and charge card providers do not require a telephone number for identification. However, where the merchant has no electronic or telephone connection with the card company to verify your account at the time of purchase, you may still be asked to provide a telephone number. Although not law in Idaho as of 1990, several states forbid merchants from compelling customers to put their addresses or phone numbers on the sales slip when making purchases by credit card.

To avoid a common source of fraud, do not allow merchants to write your credit or charge card account number on your personal check, especially if your driver's license number is being recorded as well.

Some states forbid merchants to record credit or charge card account numbers. Merchants are permitted simply to note whether you have a major credit card as an indicator of your creditworthiness. Exceptions are services like "emergency check cashing" in which you have approved the use of your card to guarantee your check. However, be forewarned: Merchants still may refuse to accept your check if you refuse to allow them to record your card number.

Secured credit cards

If you've suffered a major financial setback — had a car repossessed, lost a lawsuit, had your wages attached, had your home mortgage foreclosed or filed bankruptcy — your credit rating is probably shot. On the other hand, if you've never entered the credit world and are seeking your first credit card, banks may be rejecting your applications. In either situation, there's a way for you to get a credit card and begin rebuilding or building credit.

Many banks offer secured credit cards. Typically, a security deposit of between $500 and $5,000 gives you a credit card and a line of credit for an amount slightly less than the amount deposited. The security deposit earns interest that you collect, but you may not withdraw the deposit without surrendering the card. Extending such credit is a very low risk for the bank. If you don't pay the bill, the bank simply deducts the amount from your security deposit.

Not all secured credit cards are the same, so shop around. The interest rates are typically 18 to 24 percent with annual fees of $35 to $95. New applicants may pay a steep sign-up fee of up to $120 in addition to the first-year annual fee.

Federal enforcement agencies

The following federal agencies are responsible for enforcing federal laws that govern credit card transactions. Questions concerning a card issuer — not your credit card account — should be directed to the enforcement agency responsible:

- If your credit card or EFT card is issued by a department store, oil company or other nonbank creditor, write to Credit Cards, Correspondence Branch, Federal Trade Commission, Washington, DC 20580.
- If your card is issued by a savings and loan or federal savings bank, contact Federal Home Loan Bank Board, Office of Community Investments, Washington, DC 20552.
- If your card is issued by a federal credit union, contact National Credit Union Administration, 1776 G Street NW, Washington, DC 20456.
- For all other banks, write to Federal Reserve Board, Division of Consumer and Community Affairs, Washington, DC 20551.

Be alert to changes

Read all the literature sent with your monthly bill to be aware of changes in interest rate, costs or policies. Know when your finance charges begin and when annual membership fees are charged to your account. Being aware of all the costs — and changes in those costs — may help you decide which card to keep and which card to cancel.

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